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In the

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1961

No. 62

NORTHERN NATURAL GAS COMPANY,
a Corporation,
Appellant,
VERSUS
THE STATE CORPORATION COMMISSION OF
THE STATE OF KANSAS,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE
STATE OF KANSAS.

APPELLANT'S BRIEF OPPOSING APPELLEE'S MOTION TO DISMISS

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TEXTBOOKS AND MISCELLANEOUS:

Contractual and Property Rights as Affected by Conservation Rules and Regulations, published in 10th Annual Institute on Oil and Gas Law and Taxation by the Southwestern Legal Foundation, Dallas, Texas, at page 1 and particularly pages 13 through 15, by Richard C. Byrd, Commissioner (now Chairman), Kansas Corporation Commission 15

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In the

Supreme Court of the United States

OCTOBER TERM, 1961

No. 659

NORTHERN NATURAL GAS COMPANY,
a Corporation,
Appellant,

VERSUS

THE STATE CORPORATION COMMISSION OF
THE STATE OF KANSAS,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF KANSAS.

APPELLANT'S BRIEF OPPOSING APPELLEE'S MOTION TO DISMISS

Appellee has filed herein its Motion to Dismiss, but in support thereof has demonstrably changed the Question Presented, has misinterpreted the effect of the challenged regulations and has relied upon a decision which is clearly distinguishable.

If these appeals (as appellee asserts) were cases attacking as invalid and unconstitutional orders of the Kansas Corporation Commission limited only to securing the ratable production of natural gas by limitations placed on

producers of gas in the Kansas Hugoton Gas Field and promulgated by such Commission for the purpose of accomplishing a lawful state objective, that of preventing waste of natural gas and the protection of the correlative rights of owners of such gas in that field, these appeals would not have been filed. These cases and each of them, however, do not fall within that category. As clearly stated on page 7 of appellant's Jurisdictional Statement, the question presented in each of these cases to this Court is:

> "Does the State of Kansas have jurisdiction, under the guise of regulating production and in the face of the provisions of the Natural Gas Act and Federal Power Commission regulations thereunder, to control the sale of natural gas in interstate commerce for resale after the production and gathering thereof has ended, by directing a natural gas company purchaser, operating under subsisting gas sales contracts with its producers, to make its purchases in a manner or at a rate contrary to such contracts which are on file with the Federal Power Commission as effective rate schedules and on which certificates of public convenience and necessity authorizing such sales have been issued?"

Appellee in its Motion to Dismiss, in lieu of facing the reality of the situation and endeavoring to make answer to the real question before this Court, as posed by appellant in its Jurisdictional Statement and as set out *supra*, has deliberately, without justifying authority and unsupported by logic or reason, reframed the question presented to this Court by stating, on page 1 of such Motion to Dismiss, its own version of what it likes the question to be, namely:

"Whether the Natural Gas Act deprives the State of Kansas of the authority to prevent drainage and thus protect correlative rights of owners of natural gas resources within the state by requiring all purchasers from common sources of supply to take (purchase) gas ratably from all of the wells to which they are connected?" (Insert supplied.)

Appellee cleverly rephrases appellant's argument but in so doing misstates the actual effect of the challenged regulations. For example, on page 14 of its Motion to Dismiss, appellee states: "Appellant argues that because the orders and rules which it challenges operate upon natural gas *which is to be sold* in interstate commerce for resale, those regulations necessarily encroach unlawfully upon an area of exclusive federal jurisdiction." (Emphasis supplied.) But as appellee is (or should be) aware, these challenged regulations on their face act upon the purchase of gas, and perforce the sale of such gas in interstate commerce for resale (R. 15, 42, 84-98, 127). Necessarily, the gas in question is not gas which is to be sold, but gas which has been actually sold, the sale having already taken place. This point certainly did not escape the Kansas Supreme Court when it stated (incorrectly as we believe) that the object of the Kansas Production Statute "cannot be accomplished unless the taker or purchaser can be controlled" (R. 42, 128-158).

The apparent objective of appellee, in undertaking to reframe the question presented to this Court by appellant, is to justify, if possible, its assertion made at the outset of its Motion to Dismiss (page 3) that:

> "This litigation involves the validity of an exercise of state regulatory authority *precisely like* that sustained in *Permian Basin Pipeline Co.* v. *Railroad Commission of Texas* (1958), 358 U.S. 37, 3 L. Ed.2d 43, 79 S. Ct. 21, against the same kind of challenge that is made here." (Emphasis supplied.)

Appellee labors under the impression that because this Court in the *Permian* case dismissed the appeal from the Texas Court, or, as the case may be, denied certiorari without setting forth its reason therefor,[1] that the decision of this Court is therefore determinative as to the merits of these cases. Appellant here notes that had such been the purpose of this Court it would have dismissed the Texas appeal "for want of a substantial federal question," as it did in several other appeals disposed of by per curiam opinion on the same day the *Permian* case was decided. This Court has frequently reiterated in so many cases that the denial of a writ of certiorari imports no expression of opinion upon the merits of the case, that citation of authority therefor is unnecessary.

In the *Permian* case, this Court had before it for review the judgment and decision of the Court of Civil Appeals of Texas, Third Supreme Judicial District (1957), 302 S.W.2d 238. That Court, by its judgment and decision, had reversed the judgment of the 98th District Court of Travis County, which Court had in turn entered judgment granting temporary and permanent injunctions against the Railroad Commission of Texas, declaring invalid and prohibiting the enforcement of certain orders of the Railroad

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[1] MR. JUSTICE BLACK was of the opinion that probable jurisdiction should be noted.

Commission of Texas dealing with the ratable production and purchase of natural gas in the Puckett-Ellenberger Field in Pecos County, Texas.

Permian Case Not Comparable to Cases at Bar

A careful perusal of the opinion of the *Texas Permian Basin Pipeline Co.* case, *supra*, discloses characteristics and features that distinguish that case from these appeals and makes the *Permian* case not here controlling. Those distinctive characteristics and features are:

1. The *Permian* case dealt with a common source of supply of natural gas exclusively in Texas wherein Permian was the principal purchaser in the field. In the case at bar there is involved a single interconnected common source of supply—an interstate gas field, the Hugoton Field, one of the largest in the world, which is located in portions of three states—Kansas, Oklahoma and Texas, with numerous purchasers therein: The well established rule recently reiterated by this Court in *U. S. v. Louisiana*, 363 U.S. 1, 33, 4 L. Ed.2d 1025, 80 Sup. Ct. 961, that a land boundary between two states marks the place where the full sovereignty of one state ends and that of another begins, points up very clearly the impact and difficulty encountered in the interstate marketing of gas from such a single interconnected interstate gas field, or common source of supply, where three different state agencies possess the power of regulation therein. This is particularly true when one state in the interstate field wants to conserve its gas while another state decides that its program is to force a speedy depletion of the field. *F.P.C. v. Transcontinental Gas Corp.* (1961), 365 U.S. 1, 20, 5 L. Ed.2d

377, 390, 81 Sup. Ct. 435. The problem becomes more acute when it is recognized that for regulatory purposes the portion of this interstate field lying within each of the respective states, for the purposes of state regulation, is a separate common source of supply and under the exclusive jurisdiction of each such state. *G.S. Kan, 1949, 55-702*, Kansas Commission General Gas Conservation Rule 82-2-201, unnumbered paragraph 6.

The facts that the same pipelines and purchasers do not serve or purchase gas from each separate state portion of the interstate field, that the respective pipeline purchaser's lines are of different capacities, and the market demand or requirement for gas from each such separate portion of the field to satisfy the interstate markets of each of the respective pipeline purchasers therein is different, make the application of separate state regulation of production in such field more difficult, if not impossible, even when ratable production is the objective of each state. However, when one state's announced objective is the conservation of an exhaustible natural resource while that of another is speedy depletion thereof, serious consequences arise, as is evident in these appeals. The obvious result, as here, has been the attempted extrapolation of state power to regulate sales and volumes of gas moving in interstate commerce for resale not for the purpose of conservation but to insure to that part of the field in the state what that state believes to be its fair share of the pipeline companies' interstate markets for gas *Cf. Corporation Commission of the State of Oklahoma* v. *Champlin Refining Co.*, 286 U.S. 210, 231, 76 L. Ed. 1062, 1076, 52 Sup. Ct. 539, 563, 86 A.L.R. 403. Therein this Court said:

"The same pipelines and purchasers did not serve or take oil from all the pools, and in some the reasonable market demand was greater in proportion to potential production than in others. Some were prorated longer and had purchasers whose facilities did not extend to others."

As will be hereafter demonstrated, the words "market demands" are key words to be considered by this Court in these appeals in the determination of the validity of the purported ratable take orders issued solely against the purchasers and not against producers, of gas herein. The Supreme Court of Oklahoma, in *Peppers Refining Co.*, v. *Corporation Commission*, 179 P.2d 899, well states the meaning of the words when it said, on page 902 of the opinion:

"It seems clear to us that 'reasonable market demands' as the term is used in these statutory provisions means *the amount of oil the purchasers will buy regardless of how much the industry actually needs and irrespective of the reasonable consumptive demand of this state or of the nation.*" (Emphasis supplied.)

2. The *Permian* case dealt principally with the production of gas and the validity of the Texas Common Purchaser Act and orders of the Railroad Commission of that state supplemental thereto for the purpose of securing ratable production. Here Kansas has no common purchaser act covering natural gas as does Texas. The Kansas Commission, by Commission fiat, which has been approved by the Supreme Court of Kansas in these cases but without legislative approval, has issued its orders directed solely against the purchasers of gas, particularly Northern, as

will be hereinafter pointed out, not for the purpose of prorating production to prevent waste and protect correlative rights, but with the object of forcing Northern to increase its purchases of gas therein so that the Kansas portion of this vast interstate gas field will receive what the Kansas Commission believes to be and wants to be Kansas' fair share of the purchasing pipeline companies' interstate markets for gas. See appellant's Jurisdictional Statement, Appendix B, page XXIII, and Appendix (B) (a), pages XXIV-XXV.

3. In the *Permian* case the Court of Civil Appeals of Texas (page 252 of the opinion) made it plain that it was the intent and purpose of the Commission's order that both the producers of gas in said field and the common purchasers therein are required to conduct their operations in such manner that takes (purchases) from wells in said field will reasonably approximate actual requirements for gas in the field and the allowables assigned each of such wells so that each well will share ratably in the total field outlet. In the purported ratable take orders of the Kansas Commission involved in these appeals, such orders were made to apply only to the purchaser. No restriction was attempted to be enforced against the producer, although both the Kansas Commission and the Supreme Court of that state held that such orders here in question only applied to the production of natural gas. Notwithstanding G.S. 1959 Supp. 55-703 is purely a production statute dealing with the conservation of natural gas and which specifically requires the Kansas Commission, when circumstances in the field require the exercise of its jurisdiction, to *limit* the production of gas to

> ". . . only such portion of all the natural gas that may be currently *produced* without waste and to satisfy the market demands, as will permit each developed lease to ultimately *produce* approximately the amount of gas underlying such developed lease and currently *produce* proportionately with other developed leases in said common source of supply without uncompensated cognizable drainage between separately owned, developed leases or parts thereof." (Emphasis supplied.)

the Kansas Commission, possessed with the knowledge that Northern was obligated to purchase and receive under the Republic "A" contract the legal allowables from the Republic "A" wells (*Northern Natural Gas Co.* v. *Republic Natural Gas Co.*, 172 Kan. 450, 241 P.2d 708), saw what it thought was an opportunity to force Northern to purchase for its interstate pipeline system increased sales volumes of gas by requiring it to purchase ratably among all the wells in the field to its system connected but requiring Republic to do nothing. This exposed Northern to heavy penalties under the Kansas statute if it did not comply with such purported ratable take orders. G.S. 1949, 55-708, 709 and 710.

On the other hand if Northern did obey such orders, which it has done, it ran the hazards of threatened suits by Republic against it for money in substantial amounts (running into millions of dollars) for alleged breach of contract, since Northern's interstate markets were not sufficient to enable it to purchase the Kansas Commission fixed allowables from the wells under the Republic "A" contract and also the Kansas Commission fixed allowables

under its other 125 gas purchase contracts in said field. As a matter of fact such threatened litigation by Republic against Northern did materialize as a result of such orders.[2]

While it is Northern's position that in event the challenged regulations should herein be determined to be valid, necessarily the contract obligations would have to yield thereto, the Kansas Commission would appear to have taken a contrary position in its Order dated October 7, 1959 (R. 42,127, 72-[illegible], paragraph 5), and then reversed its position in its Motion to Dismiss at pages 16 and 17 thereof. The attendant severe statutory penalties for failure to comply with such regulations on the one hand, or, on the other, the dire consequences possibly attendant *upon compliance therewith*, as evidenced by Republic's suits,[2] make apparent the substantiality of these appeals.

Had the Kansas Commission been interested in limiting the production of gas in said field as provided by the statute and the subsisting provisions of paragraphs (f) and (g) of the Basic Proration Order for the Hugoton Gas Field (R. Case 42,128 p. 11-12, 18) to protect correlative rights and secure ratable production of gas, it would have ordered Republic in this case to shut in its wells as it was authorized to do in enforcing its Basic Proration Order for that Field, by *G.S. 1949, 55-708, 709 and 710*. As a matter of fact Kansas Commission had in the past exercised such authority and shut in the wells of the producer, Republic, for overproduction in violation of its orders. *Republic*

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[2] *Republic Natural Gas Co. v. Northern Natural Gas Co.*, Nos. W-2557 and W-2258, currently pending in the United States District Court for the District of Kansas to recover damages for alleged breach of contract in amounts aggregating in excess of $25,000,000.00.

Natural Gas Co. v. *State Corporation Commission* (1952), 173 Kan. 172, 175, 244 P.2d 1196.

4. In the *Permian* case, *supra*, the opinion of the Court of Civil Appeals of Texas, at page 242, discloses that the Railroad Commission first concluded on the representation of Phillips Petroleum Company's counsel, among other things, that fictitious nominations and market demand forecasts for gas were causing non-ratable take by the purchaser. It was, however, later ascertained by the commission that such was not the case. Fictitious market demands and allowables to wells therefore were not a factor in the decision of that court. In the *Permian* case, *supra*, there was a pre-existing order of the commission which fixed the field allowable for the Puckett Field at a figure equivalent to the capacity of the cleansing plant through which the gas had to pass before it became merchantable pipeline gas (p. 242). The problem confronting the Commission in *Permian* was that the available market demand was being allocated under contract to all of the wells in the field except one. The ratable take order in *Permian*, *supra*, provided, among other things, for the determination of market demand by means of purchaser nominations and current and retroactive adjustment of each well's allowable based upon percentage factors so that each well would produce its pro-rata share of the actual total production in the field. (*Permian*, *supra*, pp. 244, 245).[3]

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[3] Demonstrating that the Texas Railroad Commission in the *Permian* case, *supra*, UNLIKE THE KANSAS COMMISSION HERE, had as the objective for its order the protection of correlative rights and conservation rather than the enforced speedy depletion of the Puckett-Ellenberger Field, is the subsequent case of *Railroad Commission* v.

In the case at bar a totally different situation is presented. (See appellant's Jurisdictional Statement, page 10, note 16 thereto.) An excellent analysis disclosing complete understanding of the problem faced by Northern in these cases may be found in Mr. Justice Schroeder's dissenting opinion, 188 Kan. 355, 363, 372 P.2d 599, Jurisdictional Statement, Appendix A, page XIII, where it is said:

> "The record discloses that for the entire period from April 1944, through February 1958, there were no important differences between the ratable purchases by Northern from Republic 'A' wells and other wells to which it was connected. The difference in ratio was less than one times the January allowable for essentially the entire period.
>
> "However, in the spring of 1958, a wide difference in Northern's purchases appears between the Republic 'A' wells and the others.
>
> "The reason stated to the Commission and assigned by Northern for this difference is '* * * first, as the Commission is well aware, *allowables granted by the Commission to the field have exceeded the total field production by approximately 130 billion cubic feet*, and the wells connected to Northern, other than the Republic 'A' wells, have been substantially underproduced. Second, is the fact that Northern has been seriously delayed in expanding its system into new markets for gas by reason of the failure of the Federal Power Commission to issue the necessary certificates

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[3] (Continued)

Rudman (Texas Court of Civil Appeals, Feb. 22, 1961, 344 S.W.2d 211), where the court had under question the validity of a similar type order. The court held that nominations for gas made by potential purchasers would be the best forecast of market demand which could be found, and the right of each well to produce is limited to its fair share of the actual production from the field. (*Rudman, supra*, pp. 218, 219.)

of public convenience and necessity. * * *" (Emphasis added by Kansas Court.)

"Testimony on behalf of Northern was that given sufficient time it would be able to conduct its operations in such a way that the taking from the wells to which it was connected would be ratable. *This was based on the assumption that the Commission's future allowable assignments will be realistic*, and on the further assumption that the necessary expansion certificates will be issued to Northern by the Federal Power Commission.

"It must be recognized that Northern's Republic 'A' contract is subject to all valid legislation with respect to gas purchases in the Hugoton Field, either state or federal, and to all valid present and future orders, rules and regulations of duly constituted authorities having jurisdiction. (See Northern Natural Gas Co. v. Republic Natural Gas Co., 172 Kan. 450, 478; 241 P. 2d 708.) The testimony on behalf of Northern was that as far as facilities were concerned, it was not physically impossible for Northern to take gas ratably from the Republic 'A' wells and all other wells connected to its system. The evidence further disclosed that if the markets were sufficient so that Northern could take the current allowables from the Republic 'A' wells and also take the current allowable from all other wells connected to it, then Northern's take would be ratable as between all wells connected to its system. *In other words when the market conditions are at the same level as the allowables then the same rate of take would exist between the Republic 'A' wells and all other wells to which Northern was connected.* (Emphasis added by Court.)

"Theoretically, when these facts are considered in the light of the Basic Proration Order for the Hugoton

Field and the statute pursuant to which it was promulgated, if the Commission is not derelict in its duty *to correlate allowable production with the market demand*, all wells of necessity would be *produced* ratably without supplementation by any order of rule to control the *purchasers* of gas in the Hugoton Field. Taking into consideration the entire history of Northern's purchases of gas in the Hugoton Field starting from April 1944 the above theory seems to have practical application. (Emphasis added by Court.)

"It is readily apparent that any effort to control the purchase of gas, which of necessity on the facts before the Court in the instant case is limited to those wells connected to Northern's gathering system and pipeline, cannot protect the correlative rights of all producers from the common source of supply in accordance with the mandate of the statute. It fails to take into consideration those wells, potentially capable of production, which have no market for their gas, and the differential in markets among the various purchasers of gas from the common source of supply. Therefore, if the Commission fails to exercise its power *to correlate production with demand* it cannot accomplish the mandate of the statute, and resort to a method which requires the *purchasers* of gas in the Hugoton Field to take (purchase) ratably from the wells to which each is connected is little more than a futile gesture." (Emphasis added by Court.) (Insert supplied by appellant.)

It would therefore appear to be clearly manifest that the unratable production existing in the Kansas Hugoton Field was brought about in these cases by (a) Commission's own acts in fixing an unrealistic and arbitrary market demand in the Kansas Hugoton Field creating fictitious well

allowable production therein, and (b) Commission dedicating its policy not to conservation and the protection of correlative rights as authorized by the Kansas Statutes and required by the Basic Proration Order for the Kansas Hugoton Field, but by, extrapolating its authority to the forcing of more gas from the field to be sold in interstate commerce for resale so that the Kansas portion of this interstate gas field would receive what Commission and also apparently the Supreme Court of Kansas believes to be that field's fair share of the interstate markets of the respective pipeline companies purchasing gas therein.[4] Jurisdictional Statement, Appendix E, page XXIII, and Appendix B(a), pages XXIV-XXV.

5. The objectives of the Kansas Commission in these appeals, as analyzed herein and approved by the Supreme Court of Kansas, are not legitimate state objectives. As pointed out to this Court in appellant's Jurisdictional Statement, pages 24-25, this Court made it plain in the recent case of *Gomillion* v. *Lightfoot* (1960), 364 U.S. 339, 347, 5 L. Ed.2d 110, 117, 81 Sup. Ct. 125 that:

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[4] The Kansas Commission has been in recent years committed to a policy of attempting to force [illegible] purchases and volumes of gas from the Ka[illegible] interstate commerce for resale. See paper of [illegible] missioner (now Chairman) Kansas Corporation Commission entitled *Contractual and Property Rights as Affected* [illegible] *and Regulation*, published in 10th Annual [illegible] Law and Taxation by the Southwestern Legal Foundation, Dallas, Texas, 1 page 1 and particularly pages 15 [illegible] page 17 of Northern's Jurisdictional Statement [illegible] of Kansas Commission orders arbitrarily forcing [illegible] granting allowables in excess of the real [illegible] is being contested in numerous earlier cases [illegible] the Supreme Court of Kansas, including those numbered 41515, 41516, 41555 and 41556.

"When a state exercises power wholly within the domain of state interest, it is insulated from federal judicial review. *But such insulation is not carried over when state power is used as an instrument for circumventing a federally protected right. This principle has had many applications. It has long been recognized in cases which have prohibited a state from exploiting a power acknowledged to be absolute in an isolated context to justify the imposition of an 'unconstitutional condition'.*" (Emphasis added.)

The question in these appeals is not as stated by appellee in its argument on page 8 of its Motion to Dismiss, namely "whether the Natural Gas Act deprives the states of their historic authority to protect the correlative rights of owners of natural gas resources by regulation designed to assure ratable production from wells in a common source of supply," but the question is may the State of Kansas, under the guise of regulating production by legerdemain tactics regulate and control the volume of gas sold in interstate commerce for resale for the purpose of securing to the portion of a gas field in that state what its Corporation Commission believes to be the fair share of the pipeline companies' interstate markets.

Two things are really at issue here: Does the State of Kansas have the power to do indirectly what concededly it cannot do directly—to force Northern to purchase more gas from the wells to it connected in the Kansas Hugoton Gas Field; and does the State of Kansas have jurisdiction in the premises to regulate sales and purchases of such gas in interstate commerce for resale after production has ceased. At one of the hearings before the Commission, an expert witness testifying for cities Service Oil Company, which owned wells connected to Northern's lines in the

field, stated that there were two alternative solutions to the unratable situation in the field: "One is to raise the total Northern Natural's takes up until they are ratable with the Republic "A" group, and second would be to lower Republic "A" by curtailing their production so they will become ratable with the balance of the field (R. 687. R 42, 128-68)

It is significant that the regulations complained of were addressed exclusively to purchasers. It is clear, therefore, that the objective of the Kansas Commission in promulgating these regulations was neither conservation nor protection of correlative rights, but rather to force Northern to more speedily deplete the reserves underlying the wells to it connected in the Kansas Hugoton Gas Field.

The foregoing clearly reflects that the *Permian* case, *supra*, is not controlling, the real issue in these appeals must be kept in mind.

The question presented by these appeals does constitute a substantial federal question. It is of the utmost importance to the Federal Power Commission in its administration of the Natural Gas Act to know whether or not it is one of the legitimate rights of a state to control to any extent the volume of gas, after the production thereof has ceased, that is sold in interstate commerce for resale, and if so, to what extent (15 U.S.C.A. 717 et seq.). Likewise, it is essential for the respective gas pipeline companies, purchasing gas from the various common sources of supply located in the several states to satisfy their respective interstate markets, to know whether or not it is one of the legitimate rights of a state to determine to what extent, if any, a state may control the volume of

such gas, particularly when such gas has been dedicated to such interstate markets under written gas purchase contracts which are on file with the Federal Power Commission as rate schedules and on which certificates of public convenience and necessity authorizing such sales have been issued.

The law as laid down by the Supreme Court of Kansas in these cases is such that this Court, in the judgment of appellant, should take jurisdiction in these appeals, overrule appellee's Motion to Dismiss, and determine under the Natural Gas Act, the Constitution of the United States and in the public interest the extent of the power of a state, if any, to regulate in any respect the purchase and sale of gas in interstate commerce for resale.

Respectfully submitted,

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